

Private Equity Funds Adopting Higher Hurdle Rates in 2016

Fund managers respond to investor concerns, but management fees remain an issue

Preqin's 2016 Private Capital Fund Terms Advisor finds that private equity fund managers with a 2015/16 vintage fund, or with funds currently in market, are setting higher hurdle rates than in previous years, meaning that they have to reach higher performance targets before charging carried interest. In the same publication last year, Preqin found that the majority of funds (56%) were charging an 8% hurdle rate, while only 8% of funds had a higher rate, and 19% of funds had no hurdle. In 2016, the proportion of funds with an 8% hurdle rate fell to 48%, and the proportion with no hurdle fell to 13%. Conversely, the proportion of funds with a hurdle rate higher than 8% rose fourteen percentage points to 22%.

Overall, there is evidence to suggest that fund managers are making efforts to appeal to investors. The proportion of investors that report that their interests are aligned with managers' has risen from 63% in June 2014 to 79% in May 2016, the highest proportion Preqin has seen. Additionally, a third of investors report that fund terms have changed in their favour over the past 12 months. Among those who do not believe that interests are aligned, the highest proportion (64%) cited management fees as an area for improvement, followed by transparency (47%) and the amount charged in performance fees (42%).

Other Private Equity Fund Terms Facts:

- **Investor Choices:** The majority (53%) of investors report that they have occasionally decided not to invest in a fund due to the proposed terms, while 14% say that they frequently do so. Conversely, **a third (33%) of investors report that fund terms have never affected their decision whether to invest in a fund or not.**
- **Carried Interest:** Despite some recent high-profile firms announcing changes to their carried interest structure, **84% of 2015/16 funds and funds currently in market charge a 20% carry fee.** Eleven percent of funds charge a lower rate, while 5% charge a higher rate.
- **Management Fees:** Although the median management fee charged by buyout funds has stayed at 2.00% for the past 10 vintage years, the mean fee has steadily fallen. **For 2015/16 vintage funds and funds raising, the mean management fee is 1.78%,** down from the 1.99% average seen among 2010 vintage funds.
- **Fund Sizes:** The largest buyout funds charge the lowest management fees on average, and are seeing fee rates decline further in recent vintages. Peaking above 1.80% for 2010 vintage funds, the **mean management fee for buyout funds of \$1bn or more is now 1.53%,** the lowest rate seen in 10 vintage years.

To access further information and analysis, please see the sample pages below:

<https://www.preqin.com/docs/reports/2016-Preqin-Private-Capital-Fund-Terms-Advisor-Sample-Pages.pdf>

Comment:

"In negotiations over private capital fund terms, the balance of power has shifted notably towards investors over the past decade. There have been several recent instances of investors putting pressure on fund managers to adapt their fee structures, and it appears as though many managers have taken note. The proportion of investors that report that their interests are aligned with those of managers has been steadily increasing, and many are reporting shifts in their favour over the past 12 months.

In particular, many investors will be pleased to see that there has been such a notable shift towards higher hurdle rates among more recent funds. Given that many public equity markets are seeing minimal growth in investor capital, it is a mark of fund managers' confidence in their ability to provide non-correlated returns for investors. Especially for smaller or first-time fund managers, being flexible over terms such as hurdle rates can be an important way of differentiating themselves when competing for commitments from investors."

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Note to Editors:

- Preqin is spelled without the letter 'U' after the 'Q', the company name being an amalgamation of the former name, Private Equity Intelligence.

About Preqin:

Preqin is the leading source of information for the alternative assets industry, providing data and analysis via online databases, publications and bespoke data requests.

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